

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 EURE-00 SSO-00 NSCE-00 USIE-00 INRE-00

CIAE-00 PM-04 H-02 INR-07 L-03 NSAE-00 NSC-05 PA-01

PRS-01 SP-02 SS-15 USIA-06 EB-07 CIEP-01 TRSE-00

STR-04 OMB-01 CEA-01 COME-00 SIL-01 LAB-04 SAJ-01

FRB-03 XMB-02 /084 W

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O R 261807Z OCT 76

FM AMEMBASSY LONDON

TO SECSTATE WASHDC IMMEDIATE 6931

SECDEF

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY COPENHAGEN

AMEMBASSY DUBLIN

AMEMBASSY THE HAGUE

AMEMBASSY LUXEMBOURG

AMEMBASSY PARIS

AMEMBASSY ROME

USMISSION EC BRUSSELS

USMISSION NATO BRUSSELS

USMISSION OECD PARIS

AMCONSUL EDINBURGH

AMCONSUL BELFAST

C O N F I D E N T I A L SECTION 01 OF 02 LONDON 17121

PASS TREASURY AND FRB

E.O. 11652: GDS

TAGS: PGOV, EGEN, PMIL, UK

SUBJECT: CALLAGHAN REJECTS PANIC MEASURES ON ECONOMY AND
CALLS FOR ALLIED HELP

REF: LONDON 17067

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SUMMARY. REACTING TO THE PRECIPITOUS DROP IN THE POUND REGISTERED OCTOBER 25 (REFTEL), PRIME MINISTER CALLAGHAN THAT EVENING APPEARED ON BBC/TV INTERVIEW PROGRAM AND REJECTED "PANIC MEASURES" TO RESTORE CONFIDENCE IN STERLING. CALLAGHAN REAFFIRMED HIS BELIEF THAT THE GOVERNMENT'S CURRENT ECONOMIC STRATEGY IS VIABLE, ASSERTED THAT FURTHER CORRECTIVE ACTIONS WOULD HAVE TO AWAIT FORTHCOMING IMF REVIEW AND SUGGESTED THAT GERMANY AND THE U.S. SHOULD HELP FUND STERLING LIABILITIES. HE LINKED, AT LEAST IMPLICITLY, ACTION IN THIS REGARD TO BRITAIN'S ABILITY TO SUSTAIN ITS NATO CONTRIBUTION. HE ALSO STRESSED THE POLITICAL CONSTRAINTS ON THE GOVERNMENT AND THE NEED TO SUSTAIN GROWTH, SUGGESTING THAT BRITAIN'S ECONOMIC OPTIONS ARE RESTRICTED TO PHASED REDUCTION IN THE BORROWING REQUIREMENT, POSSIBLE LIMITED TAX INCREASES AND CONTINUED MONETARY CONTROL. WHILE HIS PERFORMANCE WAS BOTH SKILLFUL AND REASONED, IT IS UNLIKELY TO PROVIDE MUCH REASSURANCE FOR STERLING HOLDERS AND WILL NO DOUBT DISTURB THE ALLIANCE. END SUMMARY

1. PRIME MINISTER CALLAGHAN FACED A PANEL OF FOUR JOURNALISTS ON OCTOBER 25 PANORAMA PROGRAM (BBC/TV) IN AN INTERVIEW WHICH WAS DIRECTED LARGELY AT ECONOMIC ISSUES, PARTICULARLY STERLING WHICH HAD FALLEN OVER FIVE CENTS EARLIER IN THE DAY (REFTEL). CALLAGHAN FLATLY RULED OUT SUGGESTIONS THAT PUBLIC SPENDING BE CUT IMMEDIATELY BY SEVERAL BILLION POUNDS AND REJECTED ANY OTHER "PANIC MEASURES". RESPONDING TO QUESTIONS, HE AGREED THAT THE GOVERNMENT'S OPTIONS IN DEALING WITH BRITAIN'S ECONOMIC PROBLEMS WERE "PRETTY NARROW" IF GROWTH IS TO BE SUSTAINED -- AND INSISTED THE GOVERNMENT HAS NOT ALTERED ITS COMMITMENT TO GROWTH. SPECIFICALLY, HE SUGGESTED THE PUBLIC SECTOR BORROWING REQUIREMENT (PSBR) SHOULD BE REDUCED OVER THE NEXT TWO OR THREE YEARS AND THE PUBLIC SPENDING/GDP RATIO REDUCED. DEFENSE, HE IMPLIED, WOULD TAKE ITS FULL SHARE OF ANY CUTS. TOTAL TAXES AS A PROPORTION OF GDP COULD ALSO BE INCREASED AND CONTROLS ON MONEY SUPPLY CONTINUED. THE PROBLEMS, HE ASSERTED, COULD NOT BE OVERCOME BY A SINGLE STROKE OR IN THE NEAR-TERM, AND THE IMF WOULD HAVE TO ACCEPT THE CONFIDENTIAL

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POLITICAL CONSEQUENCES OF ANY COURSES OF ACTION IT URGED.

2. ATTRIBUTING THE OCTOBER 25 DECLINE IN STERLING TO A
SUNDAY TIMES STORY WHICH ALLEGED THAT THE IMF AND U.S.
TREASURY HAD AGREED, INTER ALIA, THAT THE POUND SHOULD BE
VALUED AT 1.50 DOLLARS, CALLAGHAN ARGUED THAT THE POUND'S
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VULNERABILITY WAS LARGELY THE PRODUCT OF ITS ROLE AS A RESERVE CURRENCY. HE FELT IT WOULD BE DESIRABLE, THEREFORE, TO GET RID OF THIS LIABILITY WHICH MIGHT BE TAKEN OVER IN SOME WAY BY GERMANY, THE U.S. AND PERHAPS JAPAN. TO SUPPORT THIS CONTENTION, HE CITED GERMANY'S CURRENT RESERVE POSITION, AND BRITAIN'S CONTRIBUTION TO EUROPEAN SECURITY. ALTHOUGH LOATH TO REDUCE BRITAIN'S NATO CONTRIBUTION, "IF WE ARE TO BE EQUAL PARTNERS IN TRYING TO KEEP THE POLITICAL STABILITY OF CENTRAL EUROPE, THEN THERE IS SOMETHING WHICH CAN BE DONE", HE SAID.

3. COMMENT. CALLAGHAN WAS LOW KEY, SERIOUS, AND OBVIOUSLY SEEKING TO REASSURE THE BRITISH PUBLIC. IT WAS A VINTAGE "UNCLE JIM" PERFORMANCE. WHETHER FOREIGN EXCHANGE MARKETS WILL FIND IT PERSUASIVE IS DOUBTFUL. HE ALSO SIGNALLED THE AREAS IN WHICH FURTHER ACTION -- PHASED CUTS IN PUBLIC SPENDING AND LIMITED TAX INCREASES, WHILE SUSTAINING GROWTH -- WOULD BE ACCEPTABLE TO THE GOVERNMENT AS A RESULT OF ITS IMF APPLICATION. CALLAGHAN'S PUBLIC ANNOUNCEMENT OF HIS DESIRE TO RID BRITAIN OF ITS RESERVE CURRENCY ROLE WAS NOT NEW, BUT THE SUGGESTION THAT GERMANY AND THE U.S. HAVE SOME RESPONSIBILITY IN THIS UNDERTAKING AND ITS LINKAGE TO BRITAIN'S NATO CONTRIBUTION WAS SURPRISING. WHILE A QUESTIONABLE TACTICAL MOVE, THESE STATEMENTS COMING FROM ONE WHO HAS BEEN SUCH A STRONG SUPPORTER OF THE ALLIANCE UNDERSCORES THE SERIOUSNESS WITH WHICH THE GOVERNMENT VIEWS THE CURRENT ECONOMIC SITUATION.

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